APPENDIX

(1) Opinion of the District Court

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT
OF NORTH CAROLINA
RALEIGH DIVISION

CAREY J. PERRY and
MARIETTA M. PERRY,

Plaintiffs

VS. CIVIL NO. 4157

UNITED STATES OF AMERICA,

Defendant

J. DOYLE MEDDERS and
CONSTANCE D. MEDDERS,

Plaintiffs

VS. CIVIL NO. 4158

UNITED STATES OF AMERICA,

Defendant

MEMORANDUM OF DECISION

In these two tax refund suits which have been consolidated and submitted to the court on cross motions for summary judgment based on an agreed statement of facts, the plain-

tiffs, Carey J. Perry and J. Doyle Medders, two physicians who practice as a partnership, seek to recover the amounts assessed and collected from them (by Perry, $1,088.92, and by Medders, $925.56) resulting from a determination by the Commissioner of Internal Revenue that the taxpayers were not entitled to deductions on their 1969 income tax returns of $4,800.00 paid by the medical partnership for the rental of an office building in Louisburg, North Carolina. Claims for refunds having been timely filed and denied, these actions were timely instituted on January 23, 1973. The court has jurisdiction of the parties and subject matter by virtue of Section 1346(a)(1), Title 28, United States Code.

The case has been submitted to the court on a joint stipulation of facts and one affidavit submitted by defendant. The facts may be briefly summarized as follows:

Prior to December, 1968, the male plaintiffs owned as tenants in common and occupied an office building in Louisburg, North Carolina, in which they conducted their medical practice. Their wives owned no interest in the property. By separate trust agreements executed in December, 1968, the plaintiffs transferred the office building to the Citizens Bank & Trust Company of Henderson, North Carolina, as trustee with their children as primary beneficiaries, and pursuant to a prearranged plan between the doctors and the trustee the office building was leased back to the doctors in two separate lease agreements for a total rental of $400 per month. The doctors continued their practice in the building as they had done since its completion in 1963. There are no other occupants or tenants of the building. The partnership paid to the trustee as lessor for the year 1969 $4,800 as rent and deducted a total of $4,800 on the partnership income tax return for that year as rental payments. The bank as trustee-lessor reported the $4,800 on its fiduciary income tax return for 1969 and claimed depreciation on the building.

Except for the names of the grantors, beneficiaries and length of term (ten years and one day in the Perry trust and fourteen years in the Medders trust), the provisions of the two trust instruments were virtually identical. Each conveyed a one-half undivided interest in the office building which the trustee was authorized to hold, manage and control and to collect and disburse the net income therefrom to or for the benefit of the grantors' children. Each contained a provision that:

> "Upon the expiration of [ten years and one day—Perry; fourteen years—Medders] from the date hereof or upon the death of the Grantor's said children, [naming them], whichever shall first occur, the trust hereunder shall terminate and the principal thereof shall be distributed to the Grantor if living, otherwise to the Grantor's estate."

The power and authority granted the trustee in each trust agreement was couched in this language:

> "I hereby grant to the Trustee of each trust established hereunder the continuing absolute, discretionary power to deal with any property, real or personal, held in any trust, as freely as I might in the handling of my own affairs. Such power may be exercised independently and without prior or subsequent approval of any court or judicial authority, and no person dealing with the Trustee shall be required to inquire into the propriety of any of their actions. Without in any way limiting the generality of the foregoing and subject to North Carolina General Statute, Section 32-26, I hereby grant to my Trustee hereunder all the powers set forth in North Carolina General Statute, Section 32-27, and these powers are hereby incorporated by reference and made a part of this instrument and such powers are

intended to be in addition to and not in substitution of the powers conferred by law."[1]

Article IV of each of the trust agreements reads as follows:

"This Agreement is hereby declared to be irrevocable and the Grantor shall have no right to alter or amend same in any respect or particular. The Grantor shall have no right, title or interest in any of the income which shall accrue during the term of the trust, and shall have no incident of ownership in the principal except the right to receive such principal upon the termination of the trust as expressly provided herein."

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[1] G.S. 32-26 permits incorporation by reference in a trust agreement of any or all of the provisions of G.S. 32-27 with the same effect as if the statutory language were set forth verbatim in the instrument. G.S. 32-27 enumerates thirty-one separate powers which may be incorporated by reference in a trust agreement as provided in G.S. 32-26, the effect of which is to vest the trustee with virtually every right, privilege and incident of ownership enjoyed by the grantor in the instrument. With respect to the management of real property the trustee is given authority in G.S. 32-27(8)e. "to lease any such property or part thereof to commence at the present or in the future, upon such terms and conditions, including options to renew or purchase, and for such period or periods of time as the fiduciary deems advisable although such period or periods may extend beyond the duration of the trust or the administration of the estate involved; h. to modify, renew or extend leases; i. to employ agents to rent and collect rents; . . . k. to erect, repair or renovate any building or other improvement on such property, and to remove or demolish any building or other improvement in whole or in part; and 1. to deal with any such property and every part thereof in all other ways and for such other purposes or considerations as it would be lawful for any person owning the same to deal with such property either in the same or in different ways from those specified elsewhere in this subdivision (8)."

With the exception of the names of the lessees and the length of the term (ten years in the lease back to Dr. Perry and fourteen years in the lease back to Dr. Medders), the provisions of the two lease agreements were also virtually identical. Each conveyed a leasehold interest in a one-half undivided interest in the office building for a rental of $200 per month with taxes to be paid by the bank as trustee, utilities to be paid by the tenant, exterior repairs to be paid by the trustee and interior repairs by the tenant; in the event of damage or destruction by fire to the extent the building cannot be repaired within thirty days, either party may terminate the lease upon written notice to the other party; and the trustee as landlord reserves the right to declare the lease terminated and cancelled if the lessee defaults in any of his obligations under the lease and remains in default for fifteen days after written notice calling his attention thereto.

In resisting the claims of these taxpayers for refunds the government has not contended that the two trust agreements are not valid "Clifford trusts" under Sections 671-678 of the Internal Revenue Code of 1954. Nor does the government contend that the amount paid as rent under the lease agreements, a total of $4,800 per year, is not reasonable. Rather, it is the government's position that the rent payments do not qualify as deductible business expenses because "(1) the lease transactions were sham transactions and should be disregarded for purposes of taxation, and (2) alternatively, the taxpayers retained an equity in the property." The court rejects each of these arguments and rules in favor of the taxpayers.

Section 162 of the Internal Revenue Code of 1954 (26 U.S.C.) reads in pertinent part as follows:

> *"Section 162. Trade or Business Expenses*
>
> "(a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or

incurred during the taxable year in carrying on any trade or business, including —

* * *

"(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

The cases which have dealt with this statute in conjunction with transfer and lease back arrangements under otherwise valid Clifford trusts have reached seemingly divergent results, but a close reading of these cases reveal that each one has been decided on its own peculiar facts and that some harmonization is possible. The government relies strongly on *Van Zandt v. Commissioner*, 341 F. 2d 440 (5th Cir. 1965), in which a physician who conveyed his office building and equipment to himself as trustee for his children in an irrevocable trust for ten years and two months was held not entitled to deduct rental payments made pursuant to a lease back of the building and equipment to himself for use in his medical practice. The court reasoned that notwithstanding this was a valid trust, there was no real business purpose served by the transaction. The court obviously felt that the control retained by the grantor was such as to render the whole transaction a sham. The decision was careful, however, not to condemn "outright and absolutely all transfers of property . . . as between a taxpayer and closely related parties . . . which result in economic benefit and income tax advantages." *Id.* p. 443.

The taxpayers here rely just as strongly on *Skemp v. Commissioner*, 168 F. 2d 598 (7th Cir. 1948). In that case a physician created an irrevocable trust for the benefit of his wife and children by conveying his office building into a corporate trust company with which he was in no way connected as stockholder or otherwise for a period of twenty

years subject to earlier termination should the physician and his wife both die. Upon the termination of the trust the property was to be distributed to the taxpayer's children, and he retained no significant control over the trust except the right to rent all or a part of the building "at a rental to be determined by the trustee." Simultaneously the taxpayer entered into a lease with the trustee for a period of ten years at a monthly rental of $500 which the Commissioner did not contend was unreasonable. In holding the rent payments deductible to the taxpayer the Seventh Circuit said:

> "Payments of rent are thus specifically included in the statute as deduction. Unless we are to impute to the trustee a violation of its fiduciary duty, the taxpayer is 'required' to pay these monthly sums—they are a legal and collectible obligation. Without further imputing such violation to the trustee, we cannot say that the taxpayer must not pay them 'as a condition to the continued use or possession'. There is no basis in the facts for such imputations, and the tax court's conclusion that the payments were gratuities is mistaken." *Id.*, p. 599.

Rejecting the Commissioner's argument that the payments as rent were not required because the taxpayer had voluntarily entered into the transaction, the court went on to say:

> "While the taxpayer voluntarily created the situation which required the payments of rent, the fact remains that the situation created did require the payments. In this case we have a valid, irrevocable trust, wholly divesting the taxpayer of any interest in the trust property, and an agreement by the taxpayer to pay the trustee a reasonable rental under a valid lease . . . The trustee was duty bound to exact rent of the taxpayer and the taxpayer was legally bound to pay it, just as much as if the taxpayer had moved across the street into the property of a third party. No one doubts that he would have had to pay rent then, and would have been entitled

to deduct it even though he had voluntarily created that situation."

In the absence of Fourth Circuit decisional guidance this court is constrained to hold that the facts of this case bring it more nearly within the reasoning of *Skemp* than *Van Zandt*. It is true, as the government suggests, that the transactions here were entered into by prearrangement, but as a practical matter this will always be so, and a prior agreement to lease standing alone has been held not to render rental payments non-deductible. *Brown v. Commissioner*, 180 F. 2d 926 (3rd Cir. 1950); *Alden B. Oakes*, 44 T.C. 524 (1965); *Albert T. Felix*, 21 T.C. 794 (1954).

Unlike the situation in *Van Zandt* where the grantor himself undertook to act as trustee, in this case the independence of the corporate trustee is about as firmly established as one could imagine. It may be true, as the government seems to argue, that in reality the trustee here is going to respect the wishes of the taxpayers, but the legal effect of the transaction into which they have entered must be judged by the instruments as executed and not on speculation. In addition to the language in the trust agreements themselves the statutory language incorporated therein by reference is about as broad as could be devised.[2]

A secondary argument advanced by the government is that the taxpayers retained an equity in the property involved and are therefore precluded under the terms of Section 162

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[2] See Footnote 1. It is understood that the lease agreements in this case are not recorded, and under North Carolina law they would not be binding on a good faith purchaser for value for a period longer than three years from the dates on which they were executed which three-year period has now expired. Thus the trustee, if it chose to do so, could sell the office building to a good faith purchaser leaving the taxpayers with only a right of action against the trustee for breach of their lease agreements. Admittedly an extremely unlikely eventuality, it is nevertheless a possibility under the trust instruments as drawn.

from deducting as business expenses the rental payments made. This argument must also be rejected. This court agrees with the Tax Court in its recent opinion in *C. James Matthews* 61 T.C. ____ (decided October 3, 1973), where it is said:

> "We are therefore of the view that Section 162 (a)(3) should not be read to cause rental payments to become non-deductible merely by virtue of a lessee's property rights in an asset, which rights are not derived from the lessor or under the lease, and which will become possessory only after the lease expires."

Traditionally the words "in which he has no equity" as used in this statute have been construed to preclude a business expense deduction for payments made by a mortgagor or conditional vendee to acquire property as distinguished from payments made for the use of the property. In this case the rental payments being made by the taxpayers do not enlarge their ownership but are simply for the use of the property during the term of the trust. See *Duffy v. United States*, 343 F. Supp. 4, 8 (S.D. Ohio 1972), *reversed on other grounds*, ___ F. 2d ___ (6th Cir., Nov. 16, 1973).

The conclusion is that the taxpayers are entitled to the refunds sued for in these actions and that their motions for summary judgment must be allowed. In conformity with the stipulations of record counsel will ascertain within sixty days from this date the exact amounts of the refunds together with interest according to law on the basis of a recomputation by the Internal Revenue Service agreed to by all parties. In the event of the failure of the parties to agree the matter will be resubmitted to the court for resolution on the basis of a supplemental stipulation of facts or upon such additional data as may be required, and judgment will be entered accordingly.

Dated: January 22, 1974.

/s/ F. T. DUPREE, JR.
F. T. Dupree, Jr.

United States District Judge

(2) Judgments of the District Court

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT
OF NORTH CAROLINA
RALEIGH DIVISION

CIVIL No. 4158

J. DOYLE MEDDERS and
CONSTANCE D. MEDDERS,

Plaintiffs

JUDGMENT

v.

UNITED STATES OF AMERICA,

Defendant

THIS CAUSE COMING ON TO BE HEARD and having been heard by the Court, and findings of fact and conclusions of law made thereon, it is hereby

ORDERED, ADJUDGED, and DECREED that the Plaintiffs, J. Doyle Medders and Constance D. Medders, have judgment against the Defendant for refund of federal income taxes in the principal amount of $925.45 for their taxable year ended December 31, 1969, plus statutory interest thereon as provided by law, and it is further

ORDERED, ADJUDGED, and DECREED that the costs of this action be taxed to the Defendant.

This 18 day of April, 1974.

/s/ F. T. DUPREE, Jr.
F. T. Dupree, Jr.

United States District Court

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT
OF NORTH CAROLINA
RALEIGH DIVISION

CIVIL NO. 4157

CAREY J. PERRY and
MARIETTA M. PERRY,

Plaintiffs

JUDGMENT

v.

UNITED STATES OF AMERICA,

Defendant

THIS CAUSE COMING ON TO BE HEARD and having been heard by the Court, and findings of fact and conclusions of law made thereon, it is hereby

ORDERED, ADJUDGED, and DECREED that the Plaintiffs, Carey J. Perry, and Marietta M. Perry, have judgment against the Defendant for refund of federal income taxes in the principal amount of $987.89 for their taxable year ended December 31, 1969, plus statutory interest thereon as provided by law, and it is further

ORDERED, ADJUDGED, and DECREED that the costs of this action be taxed to the Defendant.

This the 18th day of April, 1974.

/s/ F. T. DUPREE, Jr.
F. T. Dupree, Jr.

United States District Court

(3) Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 74-1852

Carey J. Perry and Marietta M. Perry, Appellees,

v.

United States of America, Appellant.

No. 74-1853

J. Doyle Medders and Constance D. Medders, Appellees,

v.

United States of America, Appellant.

Appeals from the United States District Court for the Eastern District of North Carolina, at Raleigh. F. T. Dupree, Jr., District Judge.

Argued March 5, 1975 Decided July 29, 1975

Before WINTER, CRAVEN and RUSSELL, Circuit Judges

WINTER, Circuit Judge:

In tax refund suits the district court gave judgment to two physicians for taxes assessed by the government and paid by them resulting from the government's disallowance of their 1969 rental payments for their medical offices. The rental payments were held to be "ordinary and necessary" business expenses deductible under § 162 of the Internal Revenue Code of 1954. 26 U.S.C. § 162(a)(3). The medical offices had been previously owned by taxpayers but leased back after they conveyed title to Clifford trusts for the benefit of their children. Because we conclude that the rental payments were not ordinary and necessary business expenses, we reverse.

I.

The facts, which were stipulated in most part, are set forth at length in the district court's memorandum of decision,[1] and they need not be repeated at length. The salient ones are that taxpayers (whose wives are joined because they filed joint income tax returns with their husbands) practice medicine in a medical partnership known as Perry-Medders Clinic. They acquired land as tenants in common and constructed on it an office building suitable for their practice. The building was completed in 1963. Ever since, it has been used for their medical practice, and taxpayers have been its sole occupants.

In 1968, each taxpayer established a Clifford trust for the benefit of his children,[2] naming the same bank as corporate trustee. Each taxpayer then conveyed his half interest in the property to the trust of which he was the settlor; it was the sole asset of his trust. The trusts were known as the Perry trust and the Medders trust. The term of the Perry trust was ten years; the term of the Medders trust was fourteen years. The provisions of the trust instruments were otherwise identical. Under each, the trustee had broad administrative powers, and remainder interests were reserved

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[1] The district court's opinion is not officially reported. It is unofficially reported at 33 AFTR 725 (1974).

[2] The parties agree that the trusts created by the taxpayers are valid under the "Clifford" sections of the Internal Revenue Code of 1954, 26 U.S.C. §§ 671-678. Congress has indicated, however, and we agree, that the issue before us must be decided without reference to the validity of the trust under the Clifford sections. See S. Rep. No. 1622, 83d Cong., 2d Sess. 365 (1954):

> The effect of this provision is to insure that taxability of Clifford type trusts shall be governed solely by this subpart .... *This subpart also has no application in determining the right of a grantor to deductions for payments to a trust under a transfer and leaseback arrangement.* (Emphasis added.)

in the settlors upon expiration of the trust, or the death of the beneficiaries, whichever should first occur.

Prior to the actual conveyance of the *res* to the trustee, a leaseback of the medical office building was arranged, and the trust instruments and leases were executed contemporaneously. Each taxpayer leased a one-half interest in the building for the same term as the term of the trust he created. Each agreed to pay a monthly rent of $200, to pay personal property taxes on equipment in the building, and to undertake interior maintenance and repairs.

II.

In concluding that the rent payments were ordinary and necessary business expenses and that taxpayers were entitled to recover the additional 1969 income taxes assessed by reason of their disallowance, the district court recognized an apparent divergence between the views expressed in *Van Zandt v. Commissioner*, 341 F. 2d 440 (5 Cir. 1965), which held that rental payments under a similar Clifford trust and leaseback arrangement were not deductible as ordinary and necessary business expenses, and *Skemp v. Commissioner*, 168 F. 2d 598 (7 Cir. 1944), which held them deductible. It followed *Skemp*, where the trustee was a bank, and distinguished *Van Zandt* on the basis that in *Van Zandt* the trustee of the Clifford trust was the settlor, who thus retained control over the trust assets. *Skemp* controlled, it was concluded, because in the instant cases a truly independent corporate trustee was named. Indeed, the district court even suggested in a footnote that the corporate trustee, by selling the property to a good-faith purchaser, had a legal right to avoid the prearranged leases because they were not recorded and under North Carolina law were not binding after the expiration of three years from the date of their execution. Although a factor probably leading to the result in *Skemp* was that, there, the settlor retained no reversionary interest in the *res* of the trust upon its termination,

while here, the property would revert to the settlors upon termination of the trusts, the district court ruled the factor irrelevant since taxpayers paid rent to use the property and not to enlarge their ownership.

We disagree. We think our cases are indistinguishable from *Van Zandt*, that the latter was correctly decided, and that it should be applied here. In *Van Zandt*, the trust and leaseback transaction was, in its essential elements, identical to the instant transactions. Dr. Van Zandt owned the office building in which he conducted his surgical practice. He conveyed it and his equipment to a trustee (himself) for his children for a term of ten years and two months, and simultaneously, as trustee, leased the property and equipment to himself as an individual. Upon the termination of the trust, its assets reverted to Dr. Van Zandt.

Prior to the transactions, Dr. Van Zandt was under no obligation to pay rent, and the court could find no business purpose in establishing the trust and in the leaseback of the *res* to justify the diversion of a part of Dr. Van Zandt's income to his children. The court was careful to point out that diversion of income was neither an illegal nor an immoral objective, but concluded that the "*obligation* to pay rent resulted not as an ordinary and necessary incident in the conduct of the business, but was in fact created solely for the purpose of permitting a division of the taxpayer's income tax." (Emphasis in original.) Accordingly, it concluded that "[r]ent paid to discharge an obligation so created is itself not an ordinary and necessary business expense." 341 F. 2d at 443.

A careful reading of the opinion in *Van Zandt* does not indicate that the fact that Dr. Van Zandt named himself as trustee was crucial to the decision of the case. Rather, the primary basis of decision was the fact that "the trustee had nothing whatever to do in the management of the trusts, except to receive the income which had been predetermined. The whole principal amount of the trust was irrevocably com-

mitted to the possession of the grantor the moment the trust was created." 341 F. 2d at 443. Viewing the creation of the trust and the leaseback as a single transaction, the court concluded that the "*obligation* to pay rent" was not an *ordinary* and *necessary* incident to a transaction with a *real* business purpose; hence, the deduction for rental payments under § 162 was disallowed.

In the instant case, notwithstanding that the bank was named as trustee, the same is true. The bank had virtually no function save to hold legal title and to receive and remit the rental payments arranged by the settlors at the time the trusts were created. The terms and conditions of the leases were fixed before the trusts were created and the durations of the leases were identical to those of the trusts. There was literally no area in which the broad powers of management vested in the bank as trustee could operate. Its "independence" from the settlors was largely illusory, and the illusion is given no substance by the mere legal possibility that the bank could breach the leases and actively manage the proceeds of sale. We think, therefore, that the taxpayers' obligations to pay rent to the bank did not result from a transaction with a real business purpose. We conclude to apply and follow *Van Zandt*.[3]

We do not find *Skemp* compelling because the result in that case rests largely on a bifurcation of the overall transaction, an approach contrary to holdings in this circuit. In

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[3] We are reinforced in our views by the decisions in *Wiles v. Commissioner*, ___ F.2d ..... (5 Cir. 1974) (per curiam) aff'g, 59 T.C. 289 (1972); *Audano v. United States*, 428 F. 2d 251 (5 Cir. 1970); *Chace v. United States*, 422 F. 2d 292 (5 Cir. 1970) (per curiam) aff'g 303 F.S. 513 (M.D. Fla. 1969); *Furman v. Commissioner*, 381 F. 2d 22 (5 Cir. 1967) (per curiam) aff'g 45 T.C. 360 (1966). See also *Brooke v. United States*, 468 F. 2d 1155, 1159 (9 Cir. 1972) (Ely, J., dissenting); *Finley v. Commissioner*, 255 F. 2d 128 (10 Cir. 1958); *White v. Fitzpatrick*, 193 F. 2d 398 (2 Cir. 1951), cert. denied 343 U.S. 928 (1952).

Skemp, the court viewed creation of the trust and the lease-back separately and not as part of an overall transaction. Thus, it held that while there was no business purpose for creation of the trust, a business purpose arose once the trust was created because the taxpayer was then required to pay rent if he wished to continue to occupy the premises. 168 F. 2d at 599-600. In our circuit we customarily view a multi-step transaction by its overall effect and not simply by scrutiny of mutually dependent steps. See, e.g., *DeTreville v. United States,* 445 F. 2d 1306 (4 Cir. 1971); *J. M. Turner & Co. v. Commissioner,* 247 F. 2d 370 (4 Cir. 1957); *Starr v. Commissioner,* 82 F. 2d 964 (4 Cir. 1936), cert. denied, 298 U.S. 680 (1936). Real business purpose, therefore, must be shown to the transaction *as a whole* before any expenditures incident to elements of the transaction can be held "ordinary and necessary" business expenses deductible under § 162.

As the *Van Zandt* court pointed out, however, under the overall approach favored in both this circuit and the Fifth Circuit, the *Skemp* result might still be reached. In *Skemp,* more property was conveyed to the trustee than was leased back to the doctor for his use and "there may have been a proper business purpose of conveying the property to the trustees for management and payment of income to the beneficiaries, since the whole income did not come from the grantor." *Van Zandt v. Commissioner,* 345 F. 2d at 442. Certainly the trustee performed functions other than being solely the conduit by which part of the doctor's earnings were diverted to his wife and children. Moreover, the grantor divested himself entirely of any interest in the property which he conveyed to the trustee because he retained no reversionary interest in the *res* upon termination of the trusts. In sum, the trustee was not obliged to administer the trust for the ultimate benefit of the grantor. Thus, rent payments by the grantor to the trustee might be part of a transaction with a real business purpose, so that a § 162 deduction would be possible. Con-

sequently we do not think that our reasoning in the instant case is inconsistent with *Skemp*.

Nor are we persuaded by the holdings in *Brooke v. United States*, supra, or *Brown v. Commissioner*, 180 F. 2d 926 (3 Cir.), cert. denied, 340 U.S. 814 (1950), both of which are cited by taxpayers. *Brooke* was decided by a divided court. While we find Judge Ely's dissent persuasive, factually there are dissimilarities between *Brooke* and the instant case which serve to distinguish the two results. Dr. Brooke did not arrange a future long-term diversion of his expected income to his children. The conveyance to taxpayer's minor children was absolute, without remainder, and not in trust. Taxpayer thereafter had himself judicially appointed as guardian for his children. There was no formal leaseback of the premises; the tenancy was from month to month. The guardianship was under continuing judicial supervision, and it and the tenancy could be terminated at any time. The property had other tenants as well as Dr. Brooke.

Unlike the case at bar, there was thus absent the relative certainty that taxpayer's income would be diverted to his children in the amounts fixed by him since the guardianship court could direct termination of the month-to-month tenancy and negotiation of a new tenancy for Dr. Brooke's continued occupancy of the property. Moreover, Dr. Brooke's rental payments were (a) only part of the total rents issuing from the property, (b) which he had irrevocably conveyed away —two indices of a transaction having a real business purpose sufficient to deem his payment of rent an ordinary and necessary business expense for him.

Brown followed the bifurcated basis of decision in *Skemp* about which we have already expressed our disapproval. It, too, was a split decision, and it, too, is at least partially factually distinguishable from the cases at bar. Taxpayers conveyed coal lands and land containing a railroad siding to their attorney, as trustee, for the benefit of their children until the eldest, age three, reached twenty-five. Taxpayers did not

reserve any reversionary interest. Taxpayers leased the railroad siding for ten years and the right to mine coal for five years; they had paid charges for the use of the siding for some time before they acquired the property on which it was located.

It is manifest that taxpayers did not control the diversion of income to their children throughout the entire terms of the trusts. Moreover, as to rent for use of the siding, the payments were a continuation of the historic pattern of use of the property to produce income, and, as to the royalty for coal mined, payment for property taken. Thus, both may be considered incidents to a transaction with economic reality and business purpose, so that payment by taxpayers was deductible under § 162.

For the reasons we have advanced, the judgments of the district court are

Reversed.

(4) Judgments of the Court of Appeals

JUDGMENT
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 74-1852

Carey J. Perry and Marietta M. Perry, Appellee,

versus

United States of America, Appellant.

APPEAL FROM the United States District Court for the Eastern District of North Carolina.

THIS CAUSE came on to be heard on the record from the United States District Court for the Eastern District of North Carolina, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, reversed.

/s/ WILLIAM K. SLATE, II, *Clerk*

Filed: July 29, 1975.

JUDGMENT
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 74-1853

J. Doyle Medders and Constance D. Medders, Appellee,

versus

United States of America, Appellant.

APPEAL FROM the United States District Court for the Eastern District of North Carolina.

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/s/ WILLIAM K. SLATE, II, *Clerk*

Filed: July 29, 1975.